Town of Palm Beach Retirement System
Board of Trustees
Minutes of March 3, 2017 Meeting

I. Call to Order and Roll Call

Chairman Pro-Tem Goldsmith called the meeting at 9:00 am in the Town of Palm Beach Hall Chambers, 360 South County Road, Palm Beach, Florida 33480

In Attendance:

TRUSTEES:
Gerald Goldsmith, Chairman Pro-Tem
Brett Madison, Secretary
Thomas Bradford, Town Manager
Daniel Stanton
Bradford Kaufman
Jeffrey Amling
Michael Marx
Daniel Wilkinson

* Wilbur Ross - resigned

ALSO PRESENT:
William P. Hanes, Retirement Administrator
Jane Struder, Finance Director
David West, AndCo Consulting
Danielle Olson, Human Resources Director
Karen Temme, Risk Manager
Judy Arenz, Arthur J. Gallagher & Co.
Moises Ariza, Marcum LLP
Tammy Goldstritch, Marcum LLP
Joe Teague, ICMA-RC
Glenn Thomas, Attorney

II. Approval of Agenda

The trustees approved the agenda without a motion.

III. Comments by Trustees

Mr. Madison commented on the opportunity to go to the Florida Public Pension Trustee Association (FPPTA) meetings. He suggested to the board to reconsider sending trustees and retirement administrator if they choose to go to these trustee events. Mr. Hanes discussed that in 2012 the new board approved a motion to allow trustees to attend and be reimbursed, but not to authorize the board to be a member system. Mr. Goldsmith asked if the Town of Palm Beach is a member of the FPPTA. Mr. Hanes answered that the Town system is not a member. Mr. Madison discussed his past experience attending the FPPTA Meetings and how beneficial it was for him. Mr. Bradford stated that he used to attend training sessions provided by the Florida Division of Retirement and asked if they are still going. Mr. West clarified that the state holds meetings twice a year in Florida in two schools. He disclosed that he is a volunteer that serves on the education committee for the FPPTA. Mr. Goldsmith stated that he likes the idea and recommends having it available to educate about particular laws applied in the state of Florida and local municipalities. Mr. Hanes stated if approved by the board that it would seem appropriate for expenses and reimbursement to be funded through the retirement trust. Mr.

Thomas clarified that the division of retirement is about compliance of state statute Chapter 185 and Chapter 175, and for the most part is for Police and Firefighters.

Mr. Stanton made the motion to approved trustee attendance at FPPTA meetings as discussed. Mr. Madison seconded the motion. The trustees unanimously approved the motion.

IV. Public Comments

None

V. Approval of Minutes: November 18, 2016

Mr. Marx made the motion to approve the minutes of November 18, 2016. Mr. Kaufman seconded the motion. The trustees unanimously approved the motion.

VI. General Employee retirement plan change, Town Manager Tom Bradford

Mr. Bradford briefly discussed the General Employee Retirement Plan changes considered by Town Council. He gave an overview of the present plan and then explained the changes. Mr. Goldsmith asked how the cash flow fund is going to be impacted with the new pension changes. Ms. Struder answered that the Town contributions under the new plan will go up with the DB plan and the DC plan contributions will drop. Mr. Goldsmith suggested Ms. Struder emphasize in the financial report if there is a cash flow deficit. Mr. Hanes clarified that there is not much of a cash flow at this time for the change in the plan, but it starts to accrue after May 1 in part due to the accrual percentage rate going from 1.25% to 1.70%. Mr. Bradford stated that all the numbers that he mentioned in his overview of the new plan were made on an actual 7.0% experience assumption, and that this fiscal year the actuarial return assumptions is at a 7.4% investment return. Mr. Stanton commented that in the year that ended June 30, 2016 some of the best performing managers around were just about 6%, and have not been able to keep up the pace with the rate the Town is assuming going forward. He commented that the return expectation for this plan is not realistic based on how the market is doing, even when at 7%. Mr. Hanes stated that Mr. Stanton reference is with regards to the expectation in market valuation, but the benchmark is in reality an actuarial valuation based on a 5-year average market return of the assets. Mr. Goldsmith stated that the actuary will inform of deficit accumulation at some point.

Mr. Madison stated that the general employees are very happy and appreciative with the changes made to the plan. Mr. Goldsmith asked if there is a source of revenue that can go specifically into the various pension funds. Mr. Bradford commented that he will keep looking and thinking of ideas. Ms. Struder commented that in the fiscal 2017 budget the Town Manager recommended and Town Council approved an extraordinary contribution to the retirement fund of $2.5 million out of the Town reserves. Mr. Goldsmith commented that he would like a specific source that goes directly to taking care of long-term obligations. Mr. Bradford suggested getting the lobbyist to change the state laws so that the Town can receive Chapter 175 /185 monies related to Firefighters and Police Officer tax subsidies, but without a requirement of providing minimum benefit requirements.

VII. Fiduciary Insurance Policy, Judy Arenz, Vice President, Arthur J. Gallagher & Co, and Karen Temme, Town Risk Management

Ms. Temme presented the Fiduciary Liability renewal. She introduced Judy Arenz with Arthur J. Gallagher, Inc.. Ms. Temme and Ms. Arenz recommended that the board approve the recommended renewal with the existing carrier Federal Insurance Co., with a $10 million dollar limit of liability and $150 thousand deductible. Mr. Kaufman asked where does the policy coverage stand in comparison with other municipalities. Ms. Arenz stated that $10 million is a very strong limit for a pension plan and for the Town of Palm Beach program. She stated that she has seen less in other municipalities because boards are looking to reduce cost, but lowering and increasing limits constantly sends a bad message. Mr. Goldsmith asked that since there have been no claims will there be a reduced premium. Ms. Arenz answered that when prices are structured they look at the area of coverage and there is slight uptake on rates in this area. Mr. Hanes stated that the Town officers have immunity through the Towns' code that applies to all board members. Mr. Stanton asked what kinds of behavior warrant a lawsuit that will trigger fiduciary liability. Ms. Arenz answered that decisions made by the Board that causes monetary damage to a participant, or a wrongful act that resulted in financial loss to the participant. Mr. Kaufman clarified it as a breach of fiduciary duty, like an undisclosed conflict of interest.

Mr. Bradford made the motion to approve the fiduciary insurance policy as recommended by the Risk Manager. Mr. Madison seconded the motion. The trustees unanimously approved the motion.

VIII. Financial Report, Jane Struder, Finance Director

Ms. Struder presented the quarterly financial report as of December 31, 2016. She noted that the Town requests $5 million dollars from the money managers for future payment of benefits and expenses of the plan.

Mr. Goldsmith made the motion to accept the financial report. Mr. Bradford seconded the motion. The trustees unanimously approved the motion.

IX. Financial Audit, Tammy Goldstritch and Moises Ariza, Marcum LLP

Mr. Ariza presented the financial independent audit report. He introduced Tammy Goldstritch, who serves as senior auditor. Mr. Ariza reviewed the Opinion Paragraph, Management Discussion and Analysis in the Audit Report. He reviewed the Statement of Fiduciary Net

Position, Statement of Changes in Fiduciary Net Position and Notes to Financial Statements. Mr. Ariza discussed the Required Supplementary Information and Combining Statement of Fiduciary Net Position. He discussed the requirements for GASB 67 and the requirements and matters of implementation of GASB 72. Mr. Ariza commented on how instrumental it was working with Mr. Hanes, Ms. Struder and their staff to finishing the financial statements. Mr. Goldsmith asked about the $4 million increase for the year, which was a book entry, in the Statement of Changes. Mr. Ariza answered that the Statement of Changes of Fiduciary Net Position is a net increase for the end of September 2016. He stated that last year there was a loss and suggested for comparative purposes and in order to be more informative for the reader they adding a column next to the 2016 amount to reflect the 2015 amount to the final draft of the report.

Mr. Bradford made the motion to approve the additional fees and retention for the auditors. Mr. Stanton seconded the motion. The trustees unanimously approved the motion.

X. Investment Report, Dave West, AndCo Consulting

a. Quarterly Investment Report for Period Ended December 2016

Mr. West commented on the degree of effort that was required to put together the new GASB 72 Report. Mr. Stanton asked what regulatory body puts in the disclosure requirement. Mr. West answered the Governmental Accounting Standards Board (GASB). Mr. West spoke of company announcements and administrative updates.

Mr. West introduced the new company name as AndCo Consultant and referenced the new look of the company logo. He stated that his partner Mr. Johnson was not present but is still working with Mr. West and that Mr. Johnson has been promoted at the company to more management responsibilities. He stated that Mr. Johnson is the co-consultant on this account, and he (Dave West) will be the lead consultant. Mr. West informed the board that AndCo hired seven new partners ranked from upper management to reporting staff, and clarified that with the name change there were no changes in personnel.

Mr. West presented the Quarterly Investment Report. He summarized the December quarterly performance including the pre-elections market in equities, post-election market in equities, and the exceptional increase in interest rates to the degree and speed. Mr. West stated that this report covers a very mixed period of investment and will be the last report that is based on the previous legacy policy statement. He noted that in mid-December the Town Council approved the new policy statement and that all future reports on asset allocation will reflect new policy targets. Mr. West discussed a summary of markets during the period. He commented there was a tectonic shift post-election in the investment theme driving all markets. He stated that the dollar was very strong, and with the post-election rally and post-election sell-off in bonds, the dollar continued with significant strength. He stated that most of the losses in the international equity markets were largely a function for us were due to currency declines. He discussed other asset class performance in the market.

Mr. West discussed what he referenced as "the trumpenomics." He stated that previously in dividend stocks and the quest for investment yield was the primary driver for the equity bull market. He commented that it brought up equities to full valuation. He commented that with the huge rotation in the markets that it will lead to a period of active management success. He said previously active managers have been challenged to meet the benchmarks, and if it is a shift in theme that is going to stick then it creates an investment environment more conducive for active managers to differentiate themselves. Mr. West stated although an extra quarter was needed to get it implemented. He said the portfolio was not implemented until December 15, 2016. He stated that they have been very careful to dollar cost average while implementing the changes. He stated that we are 98% there, without the recommendation to be made that day, which places us completely in line with the targets. He stated this explains a somewhat disappointing performance for the quarter end of December.

West reviewed the performance report and stated that the net of fee total fund performance was down .46% for the quarter, which put the one-year number at 5.38% and the three-year number at 1.72%. He contrasted with the legacy policy that was up by .39, which is not much different. He reviewed returns for each asset class.

Mr. Stanton referenced the total fund page, and noted 3 year at 1.72% and asked if it means the Town of Palm Beach total fund performance is at the 99% ranking for the three year return, Mr. West stated that it represented manager underperformance to the benchmarks compared to the public funds median performance of 4.58%. He stated that the biggest contributor to the underperformance was the active managers (or lack of performance by active managers). Mr. Stanton commented that in his view the results are a reflection of the previous consulting firm at the time with de-emphasis of domestic securities, emphasis on international, emphasis on natural resources, a lot of inflation hedge investments, and actively managed hedge funds space that massively underperformed. He commented that this is what happens when bad decisions are made with asset allocation. Mr. West stated he looks forward to better results. He continued with performance review of the managers.

Mr. Kaufman stated that he is a huge believer in active management reversion to the mean theory, and noting the active managers that are down in performance for years, asked if the active manager recommendations are being monitored and if so how long before a decision is made that the manager needs to be replaced. Mr. West answered yes, and that AndCo wanted to approach it in a manner they felt would have the greatest impact for turning the system around, and that their attention was been to focus on monitoring the manager's recommendation first. He commented they next will do a deep dive analysis on the managers. Mr. Amling asked about the period of time it takes. Mr. West replied that it is a challenging question and noted active/passive management is a cycle, but that they have placed a flag in place if manager underperforms 4 quarters in a row relative to peers, looking at opportunity costs, and relative to the passive policy benchmarks; but is not an automatic sale. He commented that the time period is soft, and actual judgment is based on a lot of criterion and circumstances.

Mr. Stanton commented related to how long you give people to stop underperformance that Warren Buffett made a bet at the end of 2007 that the S&P 500 index will outperform any grouping of five fund of fund managers that the best people could come up with for a $1 million bet to go to a charity. He stated that the period ends the end of 2017, and the S&P index is up by 66% and the Hedge fund managers are up by 21% over the period. He noted this illustrates how big the disparity is between indexing and active management selection. He commented it is staggering. He commented that it is very hard for growth managers to beat the index when so much of the performance is coming from six or seven largest cap stocks; that some managers do not want to chase them and if they are not in them they are considered to be underperforming. Mr. West agreed and stated they would be looking for those actions to make sure they are following their strategies. Mr. Kaufman stated some disagreement with how AndCo views active versus passive managers, and commented on issues of when to move out for actives and fee differentials. He stated that he has a prejudice for passive. Mr. West stated in agreement that the cost benefit ratio is very high. He stated he would like to continue the discussion of passive vs. active at a future meeting. He stated the key question is can we afford to take the manager risk and that there are strategies where there is no passive alternative. He commented that from the international equity space there is probably a higher probability for active.

Mr. Madison asked if there is something as a matter of procedure that would cause a manager to go on a watch. Mr. West answered that with the new investment policy statement there is definitive criteria to address the issue that require we act according to the process. Mr. West discussed as an example that there is a current termination recommendation he is making today with regard to a strategy used by the manager.

Mr. West completed review of the remaining manager performance. Mr. Stanton made a comment to Mr. West that while the report is based on the past quarter, the past year illustrates a portfolio that is down.

Mr. Hanes asked Mr. West to discuss the recent PEI partnership conference call. Mr. West discussed AndCo, and the Town of Palm Beach legal counsel were participants on the call. He commented that it did not seem to be informational, and in summary he believed the losses represents the poor results from bad investing. He said they did not see any violations of policy or procedures, but seemed to be bad judgment call on the investment pertaining to one company that was on the books at $37 million and investor group appropriately received an adjustment from the LP's authorizing a 20% investment rather than a previously authorized 10% limit for any single direct investment in the company. He commented that one of the partners had since been terminated and the remaining partners are continuing to run the fund. Mr. West stated from the investment consultant view the policies and procedures seemed to have been followed without deviation. Mr. Thomas stated that what he took from the call with PEI was that two of the biggest investments were bankrupt, and they do not expect proceeds from those investments.

Mr. West discussed matters of cash flow, and the net transfers from State Street as the custodian of the assets. He stated that they do not show the employer and member contributions that would show a true projection of the cash flow of the plan. He commented that AndCo would be happy to take the necessary steps to gain that information if the board would like to see a comprehensive view of the cash flow. He commented that the board does receive a complete cash flow with the annual actuarial report, but could receive on a quarterly basis with the investment consultant if they would like. Ms. Struder and Mr. Hanes stated opinions that it should be of benefit to the board. Mr. Goldsmith stated it would be helpful to him. Mr. Bradford asked Ms. Struder if it is problematic to provide the information. Ms. Struder stated she only would provide the information. Mr. West stated that he will have it worked out by the next quarterly report. Mr. West reviewed the report on cash flow. He noted that on the date of December 31, 2016 the ending market value was $198,870,076.

b. Investment Administration Update (Completed Actions)

c. Allocation Review (Strategic Update and Recommendations)

Mr. West reviewed the new asset allocation policy (new policy targets). He stated that as of February 27, 2017, domestic US equity is a little underweight, developed equity is overweight, emerging market is about on target, domestic core fixed income in on target, real estate is funded, and private equity is about on target. He stated that there are two other transactions that will be recommended, and then we will be at the new target. He discussed past transaction to reach the new asset allocation model. Mr. West stated they tried to dollar cost averaging, and noted that several of the assets that were previously liquidated had a limited liquidity and not available for daily liquidity. Mr. Kaufman asked if because of timing issues the board will be seeing the first quarter performance lagging behind the market. Mr. West stated that the plan is not in position to fully participate in the market at 100%. Mr. Stanton inquired about the allocation to hedge funds and private equity allocation, and shared concern about underperformance experienced with hedge fund investments with this plan. He asked Mr. West about managers that he will be recommending to the board. Mr. West answered that he recommended termination of underperformers. He commented that he is recommending termination of Mesirow Absolute Return fund. He stated that there are liquidation terms that do not allow us to receive the funds until after June, and we will need to raise the additional capital in June. Therefore, we will get the liquidity. He discussed a key person departure that resulted in strategic change, and that they have failed to deliver. Mr. Stanton asked Mr. West if they have someone else in mind for the hedge fund alternative space. Mr. West stated that they have a list, but at the moment they are comfortable with Weatherlow as a fund of funds manager and continue to monitor Standard Life, but need the room to consider another hedge fund. Mr. Stanton stated that since we are performing at 99%, we have had very bad performance and not knocking it out of the park. He stated his concern about future hedge fund performance with the plan. Mr. Stanton commented that he would like to see going forward something in that space that has superior characteristics and a higher probability for substantial outperformance. Mr. West stated that he would be happy to bring back a review of that space at the next meeting.

Mr. Goldsmith made the motion to terminate Mesirow and place in the redemption as soon as possible. Mr. Kaufman seconded the motion. The trustees adopted the motion unanimously.

Mr. West stated that for the next meeting they will (1) follow up and detail the cash flow, and (2) have a general hedge fund manager review with the idea of potentially replacing existing managers or to just for a general review of the space.

XI. Defined Contribution Report, Dave West, AndCo Consulting and Stephen Fiegelis, ICMA-RC

a. Quarterly Investment Report (Consolidated)

Mr. West reviewed AndCo functions with ICMA. Mr. Madison commented that the previous consultant took the offerings for the DC. Mr. Hanes stated that the previous consultant in conjunction with ICMA-RC consolidated some of the funds because they believed there were too many funds. Mr. Madison asked if there is value in reviewing what was done before. Mr. Hanes stated there will be value.

Mr. Teague introduced himself as the managing vice president of field and client relations, from the headquarters in Washington DC. He stated that he was covering for Mr. Feigelis who was not able to give the presentation. Mr. Teague presented an overview of the ICMA services.

b. Administrative Review: Plan(s) Record Keeper Annual Report (ICMA-RC)

Mr. Teague presented the annual ICMA-RC report to the Retirement Board. He reviewed the 457 deferred compensation plan and discussed the many ways employees can save. Mr. Madison commented on how the employees are reacting to the 457 plan.

XII. Attorney Report: Glenn Thomas

Mr. Thomas discussed the replacement of the Chair board member. Mr. Hanes stated that there are two reappointments that will be held at Town Council. Mr. Bradford commented that Mr. Ross structured his resignation effective upon his appointment of US Commerce Secretary. Mr.

Thomas pointed out that the committee of the government office has voted to reduce the assumed rate of return of the FRS.

XIII. Retirement Benefit Payments, William P. Hanes Administrator

Mr. Hanes reviewed the administrator's report.

Mr. Madison moved to accept the administrator's report. Mr. Bradford seconded the motion. The trustees unanimously adopted the motion.

XIV. Other business

There was no other business.

XV. Adjournment

Mr. Stanton made the motion to adjourn the meeting. Mr. Madison seconded the motion. The trustees unanimously approved the motion.

Respectfully Submitted,

Brett Madison, Secretary
Town of Palm Beach Retirement Board